

INDEPENDENCE HOLDING CO  
Form 10-Q  
August 09, 2012

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended **June 30, 2012**.

Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from: \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **0-10306**

**INDEPENDENCE HOLDING COMPANY**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**58-1407235**  
(I.R.S. Employer Identification No.)

**96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT**

**06902**

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(203) 358-8000**

**NOT APPLICABLE**

Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

**Class**  
**Common stock, \$ 1.00 par value**

**Outstanding at August 6, 2012**  
**17,956,856 Shares**

**INDEPENDENCE HOLDING COMPANY**

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Copies of the Company's SEC filings can be found on its website at [www.ihcgroup.com](http://www.ihcgroup.com).

### Forward-Looking Statements

*This report on Form 10-Q contains certain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created by those laws. We have based our forward-looking statements on our current expectations and projections about future events. Our forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as the growth of our business and operations, our business strategy, competitive strengths, goals, plans, future capital expenditures and references to future successes may be considered forward-looking statements. Also, when we use words such as anticipate, believe, estimate, expect, intend, probably or similar expressions, we are making forward-looking statements.*

*Numerous risks and uncertainties may impact the matters addressed by our forward-looking statements, any of which could negatively and materially affect our future financial results and performance. We describe some of these risks and uncertainties in greater detail in Item 1A, Risk Factors, of IHC’s annual report on Form 10-K as filed with Securities and Exchange Commission.*

*Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, also the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements that are included in this report, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved. Our forward-looking statements speak only as of the date made, and we will not update these forward-looking statements unless the securities laws require us to do so. In light of these risks, uncertainties and assumptions, any forward-looking event discussed in this report may not occur.*

**PART I - FINANCIAL INFORMATION****Item 1.****Financial Statements**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

	<b>June 30, 2012</b>	<b>December 31,</b>
	<b>(Unaudited)</b>	<b>2011</b>
<b>ASSETS:</b>		
Investments:		
Short-term investments	\$ 50	\$ 50
Securities purchased under agreements to resell	21,637	17,258
Trading securities	6,383	-
Fixed maturities, available-for-sale	717,158	842,873
Equity securities, available-for-sale	30,541	37,541
Other investments	32,245	35,223
Total investments	808,014	932,945
Cash and cash equivalents	13,401	18,227
Due from securities brokers	11,296	12,106
Deferred acquisition costs	35,601	37,101
Due and unpaid premiums	40,772	37,341
Due from reinsurers	309,299	159,729
Premium and claim funds	41,717	43,604
Notes and other receivables	17,513	15,500
Goodwill	50,318	50,318
Other assets	44,073	51,988
<b>TOTAL ASSETS</b>	<b>\$ 1,372,004</b>	<b>\$ 1,358,859</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>		
<b>LIABILITIES:</b>		
Insurance reserves-health	\$ 177,341	\$ 179,042
Insurance reserves-life and annuity	279,190	279,636
Funds on deposit	420,249	417,310
Unearned premiums	5,837	4,319
Policy claims-health	14,176	13,945
Policy claims-life	10,888	11,948
Other policyholders' funds	22,563	21,546
Due to securities brokers	4,887	383
Due to reinsurers	40,507	40,030
Accounts payable, accruals and other liabilities	61,127	66,410
Debt	10,000	10,000
Junior subordinated debt securities	38,146	38,146

<b>TOTAL LIABILITIES</b>	1,084,911	1,082,715
<b>STOCKHOLDERS' EQUITY:</b>		
<b>IHC STOCKHOLDERS' EQUITY:</b>		
Preferred stock (none issued)	-	-
Common stock \$1.00 par value, 23,000,000 and 20,000,000 shares authorized; 18,459,514 and 18,450,917 shares issued; 17,954,387 and 18,052,661 shares outstanding	18,460	18,451
Paid-in capital	126,474	126,298
Accumulated other comprehensive income	12,452	7,853
Treasury stock, at cost; 505,127 and 398,257 shares	(4,303)	(3,277)
Retained earnings	118,576	111,752
<b>TOTAL IHC STOCKHOLDERS' EQUITY</b>	<b>271,659</b>	<b>261,077</b>
<b>NONCONTROLLING INTERESTS IN SUBSIDIARIES</b>	<b>15,434</b>	<b>15,067</b>
<b>TOTAL EQUITY</b>	<b>287,093</b>	<b>276,144</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 1,372,004</b>	<b>\$ 1,358,859</b>

See the accompanying Notes to Condensed Consolidated Financial Statements.

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**  
(In thousands, except per share data)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>REVENUES:</b>				
Premiums earned:				
Health	\$ 76,466	\$ 74,738	\$ 150,751	\$ 150,461
Life and annuity	9,003	9,263	18,492	19,413
Net investment income	7,609	9,633	16,360	19,749
Fee income	5,889	8,328	13,310	15,705
Other income	1,247	1,845	2,403	3,303
Net realized investment gains (losses)	1,850	1,883	2,987	1,681
Other-than-temporary impairment losses:				
Total other-than-temporary impairment losses	(909)	(165)	(992)	(468)
Portion of losses recognized in other comprehensive income	288	-	288	-
Net impairment losses recognized in earnings	(621)	(165)	(704)	(468)
	101,443	105,525	203,599	209,844
<b>EXPENSES:</b>				
Insurance benefits, claims and reserves:				
Health	50,386	50,503	96,579	101,079
Life and annuity	9,879	11,654	20,821	25,327
Selling, general and administrative expenses	33,331	36,331	69,803	72,317
Amortization of deferred acquisitions costs	1,631	1,758	3,225	3,449
Interest expense on debt	540	460	1,079	917
	95,767	100,706	191,507	203,089
Income from operations before income taxes	5,676	4,819	12,092	6,755
Income taxes (benefits)	1,846	1,355	3,932	(509)
<b>Net income</b>	<b>3,830</b>	<b>3,464</b>	<b>8,160</b>	<b>7,264</b>
Less: income from noncontrolling interests in subsidiaries	(299)	(424)	(707)	(1,040)
	3,531	3,040	7,453	6,224
<b>NET INCOME ATTRIBUTABLE TO IHC</b>	<b>\$ 3,531</b>	<b>\$ 3,040</b>	<b>\$ 7,453</b>	<b>\$ 6,224</b>
<b>Basic income per common share</b>	<b>\$ .20</b>	<b>\$ .17</b>	<b>\$ .41</b>	<b>\$ .36</b>
<b>WEIGHTED AVERAGE SHARES OUTSTANDING</b>	<b>17,987</b>	<b>17,419</b>	<b>18,008</b>	<b>17,224</b>
<b>Diluted income per common share</b>	<b>\$ .20</b>	<b>\$ .17</b>	<b>\$ .41</b>	<b>\$ .36</b>



WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING	18,025	17,433	18,100	17,234
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**See the accompanying Notes to Condensed Consolidated Financial Statements.**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**  
(In thousands)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net income	\$ 3,830	\$ 3,464	\$ 8,160	\$ 7,264
Other comprehensive income (loss):				
Unrealized gains on available-for-sale securities, net of taxes of \$2,066, \$2,383, \$2,366 and \$2,326	6,159	6,545	6,578	6,338
Other-than-temporary impairment losses recorded in other comprehensive income, net of taxes of \$(41), \$0, \$(41) and \$0	(247)	-	(247)	-
Unrealized gains (losses) on derivative instruments, net of taxes of \$11, \$0, \$(3) and \$0	17	-	(5)	-
Allocation to deferred acquisition costs	(1,623)	(1,417)	(1,637)	(1,335)
Other comprehensive income, net of tax	4,306	5,128	4,689	5,003
<b>Comprehensive income, net of tax</b>	<b>8,136</b>	<b>8,592</b>	<b>12,849</b>	<b>12,267</b>
Comprehensive income, net of tax, attributable to noncontrolling interests:				
Income from noncontrolling interests in subsidiaries	(299)	(424)	(707)	(1,040)
Other comprehensive income, net of tax, attributable to noncontrolling interests:				
Unrealized gains on available-for-sale securities, net of tax	(162)	(287)	(129)	(256)
Other-than-temporary impairment losses recorded in other comprehensive income (loss), net of tax	36	-	36	-
Other comprehensive income, net of tax, attributable to noncontrolling interests	(126)	(287)	(93)	(256)
<b>Comprehensive income, net of tax, attributable to noncontrolling interests</b>	<b>(425)</b>	<b>(711)</b>	<b>(800)</b>	<b>(1,296)</b>
<b>Comprehensive income, net of tax, attributable to IHC</b>	<b>\$ 7,711</b>	<b>\$ 7,881</b>	<b>\$ 12,049</b>	<b>\$ 10,971</b>

**See the accompanying Notes to Condensed Consolidated Financial Statements.**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (Unaudited)**  
**SIX MONTHS ENDED JUNE 30, 2012 (In thousands)**

	COMMON STOCK	PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TREASURY STOCK, AT COST	RETAINED EARNINGS	TOTAL IHC STOCKHOLDERS' EQUITY	NON CONTRO INTERES SUBSIDIA
<b>BALANCE</b>							
<b>AT</b>							
<b>DECEMBER 31, 2011</b>	18,451\$	126,298\$	7,853\$	(3,277)\$	111,752 \$	261,077 \$	
Net income					7,453	7,453	
Other comprehensive income (loss), net of tax			4,596			4,596	
Repurchases of common stock				(1,026)		(1,026)	
Acquire noncontrolling interests in American Independence Corp.		29	3			32	
Common stock dividend (\$.035 per share)					(640)	(640)	
Share-based compensation expenses and related tax benefits	9	132				141	
Distributions to							

noncontrolling interests							-
Other capital transactions		15			11		26
<b>BALANCE AT JUNE \$ 30, 2012</b>	18,460\$	126,474\$	12,452\$	(4,303)\$	118,576 \$		271,659 \$

**See the accompanying Notes to Condensed Consolidated Financial Statements.**

**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**  
(In thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES:</b>		
Net income	\$ 8,160	\$ 7,264
Adjustments to reconcile net income to net change in cash from operating activities:		
Amortization of deferred acquisition costs	3,225	3,449
Net realized investment (gains) losses	(2,987)	(1,681)
Other-than-temporary impairment losses	704	468
Equity income from equity method investments	(556)	(714)
Depreciation and amortization	1,973	2,233
Share-based compensation expenses	633	351
Deferred tax (benefit) expense	1,945	250
Other	3,514	2,015
Changes in assets and liabilities:		
Net sales (purchases) of trading securities	(712)	-
Change in insurance liabilities	1,159	646
Additions to deferred acquisition costs, net	(3,362)	(3,786)
Change in net amounts due from and to reinsurers	(149,093)	(3,028)
Change in premium and claim funds	1,887	544
Change in current income tax liability	2,544	2,888
Change in due and unpaid premiums	(3,431)	5,492
Change in other assets	553	(2,009)
Change in other liabilities	(5,838)	(3,379)
	Net change in cash from operating activities	11,003
	(139,682)	-
<b>CASH FLOWS PROVIDED BY (USED BY) INVESTING ACTIVITIES:</b>		
Change in net amount due from and to securities brokers	5,315	(16,530)
Net sales of securities under resale and repurchase agreements	(4,379)	27,101
Sales of equity securities	4,928	30,770
Purchases of equity securities	(2,963)	(35,386)
Sales of fixed maturities	336,049	244,277
Maturities and other repayments of fixed maturities	35,893	39,792
Purchases of fixed maturities	(239,053)	(301,198)
Distributions from (additional investments in) other investments	3,535	(153)
Cash paid in acquisitions of companies, net of cash acquired	(243)	-
Change in notes and other receivables	(1,980)	(727)

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Other investing activities	(1,409)	(884)
Net change in cash from investing activities	135,693	(12,938)
<b>CASH FLOWS PROVIDED BY (USED BY) FINANCING ACTIVITIES:</b>		
Repurchases of common stock	(1,013)	(81)
Excess tax expense from expired stock options	(55)	(164)
Cash paid in acquisitions of noncontrolling interests	(58)	(1,000)
Proceeds of investment-type insurance contracts	1,338	3,390
Dividends paid	(1,051)	(375)
Other capital transactions	2	48
Net change in cash from financing activities	(837)	1,818
Net change in cash and cash equivalents	(4,826)	(117)
Cash and cash equivalents, beginning of year	18,227	11,426
Cash and cash equivalents, end of period	\$ 13,401	\$ 11,309

**See the accompanying Notes to Condensed Consolidated Financial Statements.**

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**INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**Note 1.**

**Significant Accounting Policies and Practices**

**(A)**

**Business and Organization**

Independence Holding Company, a Delaware corporation ( IHC ), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), and Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC ( Risk Solutions ), IHC Health Solutions, Inc. ( Health Solutions ), and Actuarial Management Corporation ("AMC"). These companies are sometimes collectively referred to as the Insurance Group , and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes medical stop-loss for Standard Security Life. At June 30, 2012, the Company also owned a 78.6% interest in American Independence Corp. ( AMIC ).

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 50.9% of IHC's outstanding common stock at June 30, 2012.

**(B)**

**Basis of Presentation**

The Condensed Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The Condensed Consolidated Financial Statements include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and



assumptions that affect: (i) the reported amounts of assets and liabilities; (ii) the disclosure of contingent assets and liabilities at the date of the financial statements; and (iii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. IHC's annual report on Form 10-K as filed with the Securities and Exchange Commission should be read in conjunction with the accompanying Condensed Consolidated Financial Statements.

In February 2012, IHC declared a special 10% stock dividend to shareholders of record on February 17, 2012 with a distribution date of March 5, 2012. All references to number of common shares and earnings per share amounts have been adjusted retroactively for all periods presented to reflect the change in capital structure.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The condensed consolidated results of operations for the three months and six months ended June 30, 2012 are not necessarily indicative of the results to be anticipated for the entire year.

(C)

## **Recent Accounting Pronouncements**

### ***Recently Adopted Accounting Standards***

In September 2011, the FASB issued guidance related to evaluating goodwill for impairment. The new guidance provides entities with the option to perform a qualitative assessment of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount before applying the quantitative two-step goodwill impairment test. If an entity concludes that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not be required to perform the quantitative two-step goodwill impairment test. Entities also have the option to bypass the assessment of qualitative factors for any reporting unit in any period and proceed directly to performing the first step of the quantitative two-step goodwill impairment test, as was required prior to the issuance of this new guidance. An entity may begin or resume performing the qualitative assessment in any subsequent period. This guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not have a material effect on the Company's consolidated financial statements.

In June and December 2011, the FASB issued guidance that requires all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. For public entities, the amendments were effective for fiscal years and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. This standard only affected the Company's presentation of comprehensive income and did not affect the Company's consolidated financial statements.

In May 2011, the FASB issued guidance to achieve common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. Some of the amendments in this update clarify the FASB's intent about the application of certain existing fair value measurement requirements and other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. None of the amendments in this update require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. For public entities, this guidance was effective during interim and annual periods beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not have a material effect on the Company's consolidated financial statements.

In April 2011, the FASB issued guidance that amends existing standards with regards to transfers of financial assets under repurchase and other agreements that entitle and obligate the transferor to repurchase or redeem the assets prior to maturity. Specifically, with respect to assessing effective control in such agreements, the criteria that the transferor must have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even upon the transferee's default, has been eliminated; as has the corresponding criterion calling for the transferor to have obtained cash or other sufficient collateral to purchase replacement assets from a third party, which was required to demonstrate

such ability. This guidance was effective for the first interim or annual period beginning after December 15, 2011. The adoption of this guidance, effective January 1, 2012, did not have a material effect on the Company's consolidated financial statements.

In October 2010, the FASB issued guidance that specifies the accounting treatment for the costs incurred by insurance entities when acquiring new and renewal insurance contracts. The guidance was effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance, which was applied prospectively January 1, 2012, had a negligible impact on the Company's consolidated financial statements.

***Recently Issued Accounting Standards Not Yet Adopted***

In July 2012, the FASB issued guidance to revise the subsequent measurement requirements for indefinite-lived intangible assets. In accordance with the amendments in this Update, an entity will have the option to first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this Update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In December 2011, the FASB issued guidance to amend the disclosure requirements on offsetting financial instruments and related derivatives. Entities are required to provide both net and gross information for these assets and liabilities in order to enhance comparability between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of International Financial Reporting Standards ( IFRS ). The amendments in this Update are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

In July 2011, the FASB issued guidance specifying that the liability for the fees paid to the Federal Government by health insurers as a result of recent healthcare reform legislation should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized to expense using a straight-line method of allocation unless another method better allocates the fee over the calendar year that it is payable. The amendments in this Update are effective for calendar years beginning after December 31, 2013, when the fee initially becomes effective. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

**Note 2.**

**American Independence Corp.**

In 2012 IHC acquired an aggregate 12,624 shares of AMIC common stock from noncontrolling interests for an aggregate of \$58,000 cash consideration. As a result of these transactions, the Company: (i) recorded a \$29,000 credit

to paid-in capital representing the difference between the fair value of the consideration paid and the carrying value of the noncontrolling interest; and (ii) increased its ownership interest in AMIC to 78.6%.

**Note 3.**

**Income Per Common Share**

Diluted income per share, computed using the treasury stock method, include incremental shares from; (1) the assumed exercise of dilutive stock options; (ii) the assumed vesting of dilutive restricted stock; and (iii) assumed share settlement of dilutive stock appreciation rights ( SARs ) of 38,000 and 92,000 shares, respectively, for the three months and six months ended June 30, 2012, and 14,000 and 10,000 shares, respectively, for the three months and six months ended June 30, 2011.

**Note 4.****Investments**

The cost (amortized cost with respect to certain fixed maturities), gross unrealized gains, gross unrealized losses and fair value of investment securities are as follows (in thousands):

	<b>June 30, 2012</b>			
	<b>AMORTIZED COST</b>	<b>GROSS UNREALIZED GAINS</b>	<b>GROSS UNREALIZED LOSSES</b>	<b>FAIR VALUE</b>
<b>FIXED MATURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Corporate securities	\$ 348,260	\$ 8,874	\$ (2,068)	\$ 355,066
CMOs - residential <sup>(1)</sup>	21,541	5,124	(498)	26,167
CMOs - commercial	975	-	(424)	551
U.S. Government obligations	12,963	573	-	13,536
Agency MBS - residential <sup>(2)</sup>	443	35	-	478
GSEs <sup>(3)</sup>	53,835	851	(62)	54,624
States and political subdivisions	257,852	9,444	(560)	266,736
Total fixed maturities	\$ 695,869	\$ 24,901	\$ (3,612)	\$ 717,158
<b>EQUITY SECURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Common stocks	\$ 3,963	\$ 220	\$ (58)	\$ 4,125
Preferred stock - perpetual	16,349	425	(2)	16,772
Preferred stock - with maturities	8,051	1,593	-	9,644
Total equity securities	\$ 28,363	\$ 2,238	\$ (60)	\$ 30,541
	<b>December 31, 2011</b>			
	<b>AMORTIZED COST</b>	<b>GROSS UNREALIZED GAINS</b>	<b>GROSS UNREALIZED LOSSES</b>	<b>FAIR VALUE</b>
<b>FIXED MATURITIES</b>				
<b>AVAILABLE-FOR-SALE:</b>				
Corporate securities	\$ 319,343	\$ 5,873	\$ (2,076)	\$ 323,140
CMOs - residential <sup>(1)</sup>	33,119	5,200	(1,544)	36,775
CMOs - commercial	1,448	-	(910)	538
U.S. Government obligations	164,807	1,775	-	166,582
Agency MBS - residential <sup>(2)</sup>	539	46	-	585
GSEs <sup>(3)</sup>	59,633	379	(161)	59,851

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States and political subdivisions	250,361	5,692	(651)	255,402
Total fixed maturities	\$ 829,250	\$ 18,965	\$ (5,342)	\$ 842,873

**EQUITY SECURITIES**

**AVAILABLE-FOR-SALE:**

Common stocks	\$ 6,537	\$ 311	\$ (149)	\$ 6,699
Preferred stock - perpetual	21,767	422	(451)	21,738
Preferred stock - with maturities	8,051	1,136	(83)	9,104
Total equity securities	\$ 36,355	\$ 1,869	\$ (683)	\$ 37,541

(1)

Collateralized mortgage obligations ( CMOs ).

(2)

Mortgage-backed securities ( MBS ).

(3)

Government-sponsored enterprises ( GSEs ) which are the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association and Federal Home Loan Banks. GSEs are private enterprises established and chartered by the Federal Government.

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The unrealized gains (losses) on certain available-for-sale securities (residential CMOs and certain preferred stocks with maturities) at June 30, 2012 and December 31, 2011 include \$2,185,000 and \$2,625,000, respectively, of the accumulated non-credit related component of other-than-temporary impairment losses, pretax, that were recognized in other comprehensive income.

The amortized cost and fair value of fixed maturities available-for-sale at June 30, 2012, by contractual maturity, are shown below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage-backed securities is affected by prepayments on the underlying loans and, therefore, is materially shorter than the original stated maturity.

	<b>June 30, 2012</b>		
	<b>AMORTIZED COST</b>	<b>FAIR VALUE</b>	<b>% OF TOTAL FAIR VALUE</b>
Due in one year or less	\$ 8,608	\$ 8,709	1.2%
Due after one year through five years	127,101	129,448	18.1%
Due after five years through ten years	192,419	196,396	27.4%
Due after ten years	290,947	300,785	41.9%
	619,075	635,338	88.6%
<b>CMO and MBS:</b>			
15 year	37,633	42,008	5.8%
20 year	492	502	0.1%
30 year	38,669	39,310	5.5%
<b>Total fixed maturities</b>	<b>\$ 695,869</b>	<b>\$ 717,158</b>	<b>100.0%</b>

The following tables summarize, for all available-for-sale securities in an unrealized loss position at June 30, 2012 and December 31, 2011, respectively, the aggregate fair value and gross unrealized loss by length of time those securities that have continuously been in an unrealized loss position:

	<b>June 30, 2012</b>					
	<b>Less than 12 Months</b>		<b>12 Months or Longer</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
Corporate securities	\$ 73,833	\$ 1,738	\$ 21,474	\$ 330	\$ 95,307	\$ 2,068
CMOs - residential	5,678	163	5,660	335	11,338	498



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C M O ' s - commercial	-	-	551	424	551	424
U.S. Government obligations	438	-	-	-	438	-
Agency MBS - residential	-	-	-	-	-	-
GSEs	9,219	52	468	10	9,687	62
States and political subdivisions	34,014	364	18,317	196	52,331	560
<b>Total fixed maturities</b>	123,182	2,317	46,470	1,295	169,652	3,612
Common stocks	1,144	58	-	-	1,144	58
Preferred stocks - perpetual	1,896	2	-	-	1,896	2
<b>Total temporarily impaired securities</b>	\$ 126,222	\$ 2,377	\$ 46,470	\$ 1,295	\$ 172,692	\$ 3,672

## December 31, 2011

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate securities	\$ 128,820	\$ 1,989	\$ 9,451	\$ 87	\$ 138,271	\$ 2,076
CMOs - residential	1,396	176	14,597	1,368	15,993	1,544
CMOs - commercial	-	-	538	910	538	910
Agency MBS <sup>(2)</sup>	-	-	-	-	-	-
residential						
GSEs	15,134	131	2,367	30	17,501	161
States and political subdivisions	43,978	291	20,929	360	64,907	651
<b>Total fixed maturities</b>	<b>189,328</b>	<b>2,587</b>	<b>47,882</b>	<b>2,755</b>	<b>237,210</b>	<b>5,342</b>
Common stocks	1,724	149	-	-	1,724	149
Preferred stocks-perpetual	-	-	4,968	451	4,968	451
Preferred stocks-with maturities	1,644	83	-	-	1,644	83
<b>Total temporarily impaired securities</b>	<b>\$ 192,696</b>	<b>\$ 2,819</b>	<b>\$ 52,850</b>	<b>\$ 3,206</b>	<b>\$ 245,546</b>	<b>\$ 6,025</b>

At June 30, 2012 and December 31, 2011, a total of 48 and 58 available-for-sale securities, respectively, were in a continuous unrealized loss position for less than 12 months. At June 30, 2012 and December 31, 2011 a total of 23 and 30 available-for-sale securities, respectively, were in a continuous unrealized loss position for 12 months or longer.

Substantially all of the unrealized losses on fixed maturities available-for-sale at June 30, 2012 and December 31, 2011 relate to investment grade securities and are attributable to changes in market interest rates and general disruptions in the credit market subsequent to purchase. Because the Company does not intend to sell, nor is it more likely than not that the Company will have to sell such investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2012.

At June 30, 2012, the Company had \$12,499,000 invested in whole loan CMOs backed by Alt-A mortgages. Of this amount, 21.7% were in CMOs that originated in 2005 or earlier and 78.3% were in CMOs that originated in 2006. The unrealized losses on all other CMOs relate to prime rate CMOs and are primarily attributed to general disruptions in the credit market subsequent to purchase. The Company's mortgage security portfolio has no exposure to sub-prime mortgages.

*Other-Than-Temporary Impairment Evaluations*

The Company reviews its investment securities regularly and determines whether other-than-temporary impairments have occurred. The factors considered by management in its regular review to identify and recognize other-than-temporary impairment losses on fixed maturities include, but are not limited to: the length of time and extent to which the fair value has been less than cost; the Company's intent to sell, or be required to sell, the debt security before the anticipated recovery of its remaining amortized cost basis; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; subordinated credit support; whether the issuer of a debt security has remained current on principal and interest payments; current expected cash flows; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions including the effect of changes in market interest rates. If the Company intends to sell a debt security, or it is more likely than not that it would be required to sell a debt security before the recovery of its amortized cost basis, the entire difference between the security's amortized cost basis and its fair value at the balance sheet date would be recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations. If a decline in fair value of a debt security is judged by management to be other-than-temporary and; (i) the Company does not intend to sell the security; and (ii) it is not more likely than not that it will be required to sell the security prior to recovery of the security s

amortized cost, the Company assesses whether the present value of the cash flows to be collected from the security is less than its amortized cost basis. To the extent that the present value of the cash flows generated by a debt security is less than the amortized cost basis, a credit loss exists. For any such security, the impairment is bifurcated into (a) the amount of the total impairment related to the credit loss, and (b) the amount of the total impairment related to all other factors. The amount of the other-than-temporary impairment related to the credit loss is recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations, establishing a new cost basis for the security. The amount of the other-than-temporary impairment related to all other factors is recognized in other comprehensive income in the Condensed Consolidated Statement of Comprehensive Income. It is reasonably possible that further declines in estimated fair values of such investments, or changes in assumptions or estimates of anticipated recoveries and/or cash flows, may cause further other-than-temporary impairments in the near term, which could be significant.

In assessing corporate debt securities for other-than-temporary impairment, the Company evaluates the ability of the issuer to meet its debt obligations and the value of the company or specific collateral securing the debt position. For mortgage-backed securities where loan level data is not available, the Company uses a cash flow model based on the collateral characteristics. Assumptions about loss severity and defaults used in the model are primarily based on actual losses experienced and defaults in the collateral pool. Prepayment speeds, both actual and estimated, are also considered. The cash flows generated by the collateral securing these securities are then determined with these default, loss severity and prepayment assumptions. These collateral cash flows are then utilized, along with consideration for the issuer's position in the overall structure, to determine the cash flows associated with the mortgage-backed security held by the Company. In addition, the Company evaluates other asset-backed securities for other-than-temporary impairment by examining similar characteristics referenced above for mortgage-backed securities. The Company evaluates U.S. Treasury securities and obligations of U.S. Government corporations, U.S. Government agencies, and obligations of states and political subdivisions for other-than-temporary impairment by examining the terms and collateral of the security.

Equity securities that are available-for-sale may experience other-than-temporary impairment in the future based on the prospects for full recovery in value in a reasonable period of time and the Company's ability and intent to hold the security to recovery. If a decline in fair value is judged by management to be other-than-temporary or management does not have the intent or ability to hold a security, a loss is recognized by a charge to total other-than-temporary impairment losses in the Condensed Consolidated Statement of Operations. For the purpose of other-than-temporary impairment evaluations, preferred stocks with maturities are treated in a manner similar to debt securities. Declines in the creditworthiness of the issuer of debt securities with both debt and equity-like features requires the use of the equity model in analyzing the security for other-than-temporary impairment.

Subsequent increases and decreases, if not an other-than-temporary impairment, in the fair value of available-for-sale securities that were previously impaired, are included in other comprehensive income.

For the three-month and six-month periods ended June 30, 2012, the Company recorded other-than-temporary impairments in earnings of \$621,000 and \$704,000, respectively, consisting of credit losses recorded as a result of expected cash flows on certain debt securities less than their amortized cost. For the three-month and six-month periods ended June 30, 2011, the Company recorded other-than-temporary impairments in earnings of \$165,000 and \$468,000, respectively, consisting of credit losses recorded as a result of expected cash flows of certain debt securities

less than their amortized cost. The Company recognized \$288,000 of non-credit related other-than-temporary impairment losses, pre-tax, in other comprehensive income for the three and six months ended June 30, 2012. No losses for other-than-temporary impairments were recognized in other comprehensive income for the three months and six months ended June 30, 2011.

Credit losses were recognized on certain impaired fixed maturities and preferred stocks with maturities, for which each security also had an impairment loss recognized in other comprehensive income.

The rollforward of these credit losses were as follows (in thousands):

	<b>2012</b>	<b>2011</b>
Balance at beginning of year	\$ 2,555	\$ 1,763
Credit losses during the period for which an other-than-temporary loss was not previously recognized	473	-
Additional credit losses for which an other-than-temporary loss was previously recognized	148	-
Securities sold	(576)	-
Balance at end of period	\$ 2,600	\$ 1,763

Further deterioration in credit quality of the companies backing the securities, further deterioration in the condition of the financial services industry, a continuation of the current imbalance in liquidity that exists in the marketplace, a continuation or worsening of the current economic recession, or additional declines in real estate values may further affect the fair value of these securities and increase the potential that certain unrealized losses be designated as other-than-temporary in future periods and the Company may incur additional write-downs.

#### **Note 5.**

##### **Derivative Instruments**

In connection with its outstanding \$10,000,000 amortizing term loan, a subsidiary of IHC entered into an interest rate swap on July 1, 2011 with the commercial bank lender, for a notional amount equal to the debt principal amount, under which the Company receives a variable rate equal to the rate on the debt and pays a fixed rate (1.60%) in order to manage the risk in overall changes in cash flows attributable to forecasted interest payments. As a result of the interest rate swap, interest payments on this debt are fixed at 4.95%. There was no hedge ineffectiveness on this interest rate swap which was accounted for as a cash flow hedge. The fair value of the interest rate swap was \$503,000 and \$494,000 at June 30, 2012 and December 31, 2011, respectively, which is included in other liabilities on the accompanying Condensed Consolidated Balance Sheets. See Note 7 for further discussion on the valuation techniques utilized to determine the fair value of the interest rate swap. For the three months and six months ended June 30, 2012, the Company recorded gains (losses) of \$17,000 and \$(5,000), respectively (net of related tax expense (benefits) of \$11,000 and \$(3,000), respectively), representing the after-tax change in fair value of the interest rate swap, in other comprehensive income on the accompanying Condensed Consolidated Statements of Comprehensive Income.



**Note 6.****Net Realized Investment Gains (Losses)**

Net realized investment gains (losses) for the three months and six months ended June 30, 2012 and 2011 are as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Sales of available-for-sale securities:				
Fixed maturities	\$ 2,101	\$ 1,778	\$ 3,343	\$ 283
Common stocks	-	19	-	(26)
Preferred stocks	-	86	(491)	1,424
Total sales of available-for-sale securities	2,101	1,883	2,852	1,681
Sales of trading securities	(151)	-	105	-
Total realized gains (losses)	1,950	1,883	2,957	1,681
Unrealized gains (losses) on trading securities:				
Available-for-sale securities transferred to trading category	-	-	138	-
Change in unrealized gains (losses) on trading securities	(100)	-	(108)	-
Total unrealized gains (losses) on trading securities	(100)	-	30	-
Net realized investment gains (losses)	\$ 1,850	\$ 1,883	\$ 2,987	\$ 1,681

For the three months and six months ended June 30, 2012, the Company realized gross gains of \$2,799,000 and \$6,089,000, respectively, and realized gross losses of \$698,000 and \$3,237,000, respectively, on sales of available-for-sale securities. For the three months and six months ended June 30, 2011, the Company realized gross gains of \$3,085,000 and \$6,617,000, respectively, and realized gross losses of \$1,202,000 and \$4,936,000, respectively, on sales of available-for-sale securities.

On January 1, 2012, the Company transferred equity securities previously classified as available-for-sale into the trading category and, as a result, recognized \$287,000 of gross gains and \$149,000 of gross losses in net realized investment gains on the accompanying Condensed Consolidated Statement of Operations. These gains and losses were previously included in accumulated other comprehensive income on the accompanying Condensed Consolidated Balance Sheet at December 31, 2011.



**Note 7.**

**Fair Value Disclosures of Financial Instruments**

For all financial and non-financial assets and liabilities accounted for at fair value on a recurring basis, the Company utilizes valuation techniques based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market expectations. These two types of inputs create the following fair value hierarchy:

**Level 1** - Quoted prices for identical instruments in active markets.

**Level 2** - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

**Level 3** - Instruments where significant value drivers are unobservable.

The following section describes the valuation methodologies we use to measure different assets at fair value.

**Investments in fixed maturities and equity securities:**

Available-for-sale securities included in Level 1 are equities with quoted market prices. Level 2 is primarily comprised of our portfolio of government securities, agency mortgage-backed securities, corporate fixed income securities, collateralized mortgage obligations, municipals, GSEs and certain preferred stocks that were priced with observable market inputs. Level 3 securities consist primarily of CMO securities backed by Alt-A mortgages. For these securities, we use industry-standard pricing methodologies, including discounted cash flow models, whose inputs are based on management's assumptions and available market information. Significant unobservable inputs used in the fair value measurement of CMOs are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for loss severity and a directionally opposite change in the assumption used for prepayment rates. Further we retain independent pricing vendors to assist in valuing certain instruments.

**Trading securities:**

Trading securities included in Level 1 are equity securities with quoted market prices.

**Interest rate swap:**

The financial liability included in Level 2 consists of an interest rate swap on IHC debt. It is valued using market observable inputs including market price, interest rate, and volatility within a Black Scholes model.



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The following tables present our financial assets and liabilities measured at fair value on a recurring basis, at June 30, 2012 and December 31, 2011, respectively (in thousands):

	<b>June 30, 2012</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
<b>FINANCIAL ASSETS:</b>				
Fixed maturities available-for-sale:				
Corporate securities	\$ -	\$ 355,066	\$ -	\$ 355,066
CMOs - residential	-	13,198	12,969	26,167
CMOs - commercial	-	-	551	551
US Government obligations	-	13,536	-	13,536
Agency MBS - residential	-	478	-	478
GSEs	-	54,624	-	54,624
States and political subdivisions	-	264,122	2,614	266,736
Total fixed maturities	-	701,024	16,134	717,158
Equity securities available-for-sale:				
Common stocks	4,125	-	-	4,125
Preferred stocks - perpetual	16,772	-	-	16,772
Preferred stocks - with maturities	9,644	-	-	9,644
Total equity securities	30,541	-	-	30,541
Trading securities - equities	6,383	-	-	6,383
Total trading securities	6,383	-	-	6,383
<b>Total Financial Assets</b>	<b>\$ 36,924</b>	<b>\$ 701,024</b>	<b>\$ 16,134</b>	<b>\$ 754,082</b>
<b>FINANCIAL LIABILITIES:</b>				
Interest rate swap	\$ -	\$ 503	\$ -	\$ 503

	<b>December 31, 2011</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
<b>FINANCIAL ASSETS:</b>				
Fixed maturities available-for-sale:				
Corporate securities	\$ -	\$ 323,140	\$ -	\$ 323,140
CMOs - residential	-	14,648	22,127	36,775
CMOs - commercial	-	-	538	538
US Government obligations	-	166,582	-	166,582
Agency MBS - residential	-	585	-	585
GSEs	-	59,851	-	59,851
States and political subdivisions	-	255,402	-	255,402
Total fixed maturities	-	820,208	22,665	842,873
Equity securities available-for-sale:				
Common stocks	6,699	-	-	6,699
Preferred stocks - perpetual	21,738	-	-	21,738
Preferred stocks - with maturities	9,104	-	-	9,104
Total equity securities	37,541	-	-	37,541
<b>Total Financial Assets</b>	<b>\$ 37,541</b>	<b>\$ 820,208</b>	<b>\$ 22,665</b>	<b>\$ 880,414</b>
<b>FINANCIAL LIABILITIES:</b>				
Interest rate swap	\$ -	\$ 494	\$ -	\$ 494

It is the Company's policy to recognize transfers of assets and liabilities between levels of the fair value hierarchy at the end of a reporting period. At June 30, 2012, there were no transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy. No securities were transferred out of Level 2 and into the Level 3 category at June 30, 2012. The Company does not transfer out of Level 3 and into Level 2 until such time as observable inputs become available and reliable or the range of available independent prices narrow. No securities were transferred out of the Level 3 category in 2012. The changes in the carrying value of Level 3 assets and liabilities for the six months ended June 30, 2012 are summarized as follows (in thousands):

	<b>June 30, 2012</b>			
	<b>CMOs</b>		<b>States and Political Subdivisions</b>	<b>Total</b>
	<b>Residential</b>	<b>Commercial</b>		
Beginning balance	\$ 22,127	\$ 538	\$ -	\$ 22,665
Purchases of securities	-	-	2,135	2,135
Gains(losses) included in earnings:				
Net realized investment losses	(1,212)	-	-	(1,212)

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Other-than-temporary impairments	(231)	(473)	-	(704)
Net unrealized gains (losses) included in accumulated other comprehensive loss	1,070	486	454	2,010
Sales of securities	(7,087)	-	-	(7,087)
Repayments and amortization of fixed maturities	(1,698)	-	25	(1,673)
Balance at end of period	\$ 12,969	\$ 551	\$ 2,614	\$ 16,134

The following table provides carrying values, fair values and classification in the fair value hierarchy of the Company's financial instruments that are not carried at fair value but are subject to fair value disclosure requirements at June 30, 2012 and December 31, 2011 (in thousands):

	June 30, 2012		December 31, 2011	
	Level 2 Fair Value	Carrying Value	Level 2 Fair Value	Carrying Value
<b>FINANCIAL ASSETS:</b>				
Policy loans	\$ 28,687	\$ 22,436	\$ 29,511	\$ 23,109
<b>FINANCIAL LIABILITIES:</b>				
Funds on deposit	\$ 423,029	\$ 420,249	\$ 418,823	\$ 417,310
Debt and junior subordinated debt securities	\$ 48,146	\$ 48,146	\$ 48,146	\$ 48,146

The following methods and assumptions were used to estimate the fair value of the financial instruments that are not carried at fair value in the Condensed Consolidated Financial Statements:

**(A)**

**Policy Loans**

The fair value of policy loans included in Level 2 of the fair value hierarchy is estimated by projecting aggregate loan cash flows to the end of the expected lifetime period of the life insurance business at the average policy loan rates, and discounting them at a current market interest rate.

**(B)**

**Funds on Deposit**

The Company has two types of funds on deposit. The first type is credited with a current market interest rate, resulting in a fair value which approximates the carrying amount. The second type carries fixed interest rates which are higher than current market interest rates. The fair value of these deposits was estimated by discounting the payments using current market interest rates. The Company's universal life policies are also credited with current market interest rates, resulting in a fair value which approximates the carrying amount. Both types of funds on deposit are included in Level 2 of the fair value hierarchy.

(C)

**Debt**

The fair value of debt with variable interest rates approximates its carrying amount and is included in Level 2 of the fair value hierarchy.



**Note 8.****Goodwill and Other Intangible Assets**

The change in the carrying amount of goodwill and other intangible assets (included in other assets in the Condensed Consolidated Balance Sheets) for the first six months of 2012 is as follows (in thousands):

	<b>Other Intangible Assets</b>			
	<b>Goodwill</b>	<b>Definitive Lives</b>	<b>Indefinite Lives</b>	<b>Total Other Intangible Assets</b>
<b>Balance at December 31, 2011</b>	\$ 50,318	\$ 9,738	\$ 7,977	\$ 17,715
Fully insured:				
Acquired CPR	-	327	-	327
Capitalized software development	-	144	-	144
Amortization expense	-	(1,234)	-	(1,234)
<b>Balance at June 30, 2012</b>	\$ 50,318	\$ 8,975	\$ 7,977	\$ 16,952

In February 2012, the Company acquired the net assets of CPR Risk Management, Inc. ( CPR ) for an aggregate purchase price of \$275,000. The Company recorded other intangible assets of \$327,000 representing customer relationships, which is being amortized over a weighted average period of 5.0 years.

**Note 9.****Common Stock**

IHC issued 1,638,849 shares of common stock, net of treasury shares, in connection with a special 10% stock dividend payable to shareholders of record on February 17, 2012 with a distribution date of March 5, 2012. Accordingly, IHC charged retained earnings \$15,799,000, representing the fair value of such shares on the distribution date, and recorded a credit to common stock for the par value of such shares and a credit to paid-in capital for the remaining difference. Fractional shares were paid in cash in-lieu of stock. All references to number of common shares and earnings per share amounts have been adjusted retroactively for all periods presented to reflect the change in capital structure.

In February 2012, IHC announced it will increase its annual dividend from \$.05 to \$.07 per share.

In June 2012, the stockholders of the Company approved an amendment to the Company's restated certificate of incorporation to increase the number of authorized shares of common stock from 20,000,000 shares to 23,000,000 shares.

**Note 10.**

**Share-Based Compensation**

IHC and AMIC each have share-based compensation plans. The following is a summary of the activity pertaining to each of these plans.

**A) IHC Share-Based Compensation Plans**

Total share-based compensation expense was \$147,000 and \$205,000 for the three months ended June 30, 2012 and 2011, respectively, and was \$617,000 and \$327,000 for the six months ended June 30, 2012 and 2011, respectively. Related tax benefits of \$59,000 and \$82,000 were recognized for the three months ended June 30, 2012 and 2011, respectively and \$246,000 and \$130,000 were recognized for the six months ended June 30, 2012 and 2011, respectively.

Under the terms of IHC's stock-based compensation plans, option exercise prices are more than or equal to the quoted market price of the shares at the date of grant; option terms range from five to ten years; and vesting periods are three years for employee options. The Company may also grant shares of restricted stock, share appreciation rights (SARs) and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant and have a three year vesting period. Exercise prices of SARs are more than or equal to the quoted market price of IHC shares at the date of the grant and have three year vesting periods.

At June 30, 2012, there were 378,472 shares available for future stock-based compensation grants under IHC's stock incentive plans.

### Stock Options

The Company's stock option activity for the six months ended June 30, 2012 is as follows:

	<b>Shares Under Option</b>	<b>Weighted- Average Exercise Price</b>
<b>December 31, 2011</b>	758,714	\$ 9.71
Expired	(26,378)	18.91
<b>June 30, 2012</b>	732,336	\$ 9.38

The following table summarizes information regarding outstanding and exercisable options:

	<b>June 30, 2012</b>	
	<b>Outstanding</b>	<b>Exercisable</b>
Number of options	732,336	563,009
Weighted average exercise price per share	\$ 9.38	\$ 9.47
Aggregate intrinsic value for all options	\$ 386	\$ 257
Weighted average contractual term remaining	2.0 years	1.8 years

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. No options were granted during the six months ended June 30, 2012 or 2011.

Compensation expense of \$60,000 and \$61,000 was recognized in the three months ended June 30, 2012 and 2011, respectively, and \$121,000 and \$171,000 was recognized in the six months ended June 30, 2012 and 2011, respectively, for the portion of the grant-date fair value of stock options vesting during that period.

No options were exercised during the three months and six months ended June 30, 2012 or 2011.

As of June 30, 2012, the total unrecognized compensation expense related to non-vested stock options was \$121,000 which is expected to be recognized over the remaining requisite weighted-average service period of 0.5 years.

### **Restricted Stock**

IHC granted 7,425 shares of restricted stock awards during the six months ended June 30, 2012 with a weighted average grant-date fair value of \$9.39 per share. No shares of restricted stock were issued by IHC during the first six months of 2011. The total fair value of restricted stock that vested during each of the first six months of 2012 and 2011 was \$16,000 and \$23,000, respectively. Restricted stock expense was \$9,000 and \$4,000 for the three months ended June 30, 2012 and 2011, respectively, and was \$18,000 and \$9,000 for the six months ended June 30, 2012 and 2011, respectively.

The following table summarizes restricted stock activity for the six months ended June 30, 2012:

	<b>No. of Non-vested Shares</b>	<b>Weighted-Average Grant-Date Fair Value</b>
December 31, 2011	9,900	\$ 8.95
Granted	7,425	9.39
Vested	(1,650)	6.25
June 30, 2012	15,675	\$ 9.44

As of June 30, 2012, the total unrecognized compensation expense related to non-vested restricted stock awards was \$122,000 which is expected to be recognized over the remaining requisite weighted-average service period of 2.4 years.

### **SARs and Share-Based Performance Awards**

IHC had 274,450 and 230,450 SAR awards outstanding at June 30, 2012 and December 31, 2011, respectively. During the first six months of 2012 and 2011, the Company granted 44,000 SAR awards and 98,600 SAR awards, respectively. The fair value of SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement. For the three months ended June 30, 2012 and 2011, IHC recorded \$58,000 and \$110,000, respectively, of compensation costs for these awards, and for the six months ended June 30, 2012 and 2011, recorded \$451,000 and \$125,000, respectively. No SARs were exercised during the six months ended June 30, 2012 or 2011. Included in Other Liabilities in the Company's Condensed Consolidated Balance Sheets at June 30, 2012 and December 31, 2011 are liabilities of \$739,000 and \$288,000, respectively, pertaining to SARs.

Other outstanding awards include share-based performance awards. Compensation costs for these awards are recognized and accrued as performance conditions are met, based on the current share price. For the three months ended June 30, 2012 and 2011, IHC recorded \$18,000 and \$30,000, respectively, of compensation costs for these awards, and for the six months ended June 30, 2012 and 2011, recorded \$27,000 and \$21,000. The intrinsic value of share-based performance awards paid during the six months ended June 30, 2012 and 2011 was \$57,000 and \$47,000, respectively. Included in the other liabilities on the Company's Condensed Consolidated Balance Sheets at June 30, 2012 and December 31, 2011 are liabilities of \$35,000 and \$65,000, respectively, pertaining to share-based performance awards.

**B)**

**AMIC Share-Based Compensation Plans**

Total AMIC share-based compensation expense was \$8,000 and \$9,000 for the three months ended June 30, 2012 and 2011, respectively and was \$16,000 and \$25,000 for the six months ended June 30, 2012 and 2011, respectively. Related tax benefits of \$3,000 and \$3,000 were recognized for the three months ended June 30, 2012 and 2011, respectively and were \$6,000 and \$9,000 for the six months ended June 30, 2012 and 2011, respectively.

Under the terms of the AMIC's stock-based compensation plan, option exercise prices are equal to the quoted market price of the shares at the date of grant; option terms are ten years; and vesting periods range from three to four years. AMIC may also grant shares of restricted stock, stock appreciation rights and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant, and have a three year vesting period.

**Stock Options**

The following table summarizes information regarding AMIC's outstanding and exercisable options for the six months ended June 30, 2012:

	<b>Shares Under Option</b>	<b>Weighted- Average Exercise Price</b>
<b>December 31, 2011</b>	333,956	\$ 10.43
Forfeited	(16,668)	11.10
<b>June 30, 2012</b>	317,288	\$ 10.40

The following table summarizes information regarding AMIC's outstanding and exercisable options:

	<b>June 30, 2012</b>	
	<b>Outstanding</b>	<b>Exercisable</b>
Number of options	317,288	299,509
Weighted average exercise price per share	\$ 10.40	\$ 10.70
Aggregate intrinsic value for all options	\$ 5,312	\$ 2,956
Weighted average contractual term remaining	2.68 years	2.33 years

The fair value of an option award is estimated on the date of grant using the Black-Scholes option valuation model. No options were granted during the six months ended June 30, 2012. The weighted average grant-date fair value of options granted during the six months ended June 30, 2011 was \$3.24 per share. The assumptions set forth in the table below were used to value the stock options granted during the six months ended June 30, 2011:

	<b>2011</b>
Weighted-average risk-free interest rate	2.95%
Annual dividend rate per share	\$ -
Weighted-average volatility factor of the Company's common stock	37.07
Weighted-average expected term of options	5 years

Compensation expense of \$8,000 and \$6,000 was recognized for the three months ended June 30, 2012 and 2011, respectively, and was \$16,000 and \$18,000 for the six months ended June 30, 2012 and 2011, respectively, for the portion of the grant-date fair value of AMIC's stock options vesting during those periods.

No options were exercised during the six months ended June 30, 2012. AMIC received cash proceeds of \$48,000 upon the exercise of 11,389 options with an intrinsic value of \$8,000 during the six months ended June 30, 2011.

As of June 30, 2012, the total unrecognized compensation expense related to AMIC's non-vested options was \$64,000 which will be recognized over the remaining requisite service periods.

### **Restricted Stock**

AMIC issued 12,000 restricted stock awards in the second quarter of 2008, with a weighted average grant-date fair value of \$6.92 per share. No restricted stock awards have been issued since then. AMIC had no unvested restricted stock awards outstanding at June 30, 2012 and December 31, 2011. Restricted stock expense for the three months and six months ended June 30, 2011 was \$3,000 and \$7,000, respectively.



**Note 11.**

**Income Taxes**

The provision for income taxes shown in the Condensed Consolidated Statements of Operations was computed based on the Company's actual results which approximate the effective tax rate expected to be applicable for the balance of the current fiscal year in accordance with consolidated life/non-life group income tax regulations. Such regulations adopt a subgroup method in determining consolidated taxable income, whereby taxable income is determined separately for the life insurance company group and the non-life insurance company group.

The deferred income tax expense for the six months ended June 30, 2012 allocated to stockholders' equity (principally for net unrealized gains on investment securities) was \$2,322,000, representing the increase in the related deferred tax liability from \$3,768,000 at December 31, 2011 to \$6,090,000 at June 30, 2012.

In 2011, the Company recorded a deferred income tax benefit of \$2,319,000 associated with IHC's investment in AMIC. As the result of management's intention to adopt tax planning strategies to recover IHC's investment in AMIC in a tax-free manner, the cumulative Federal and State deferred income tax liabilities established as of December 31, 2010 for temporary differences between IHC's book value and tax basis in AMIC became permanent. Accordingly, IHC released its previously recorded deferred income tax liabilities and will not record deferred income taxes in future periods for any earnings or stockholders' equity adjustments relating to IHC's investment in AMIC.

At June 30, 2012, AMIC, had net operating loss carryforwards of approximately \$273,159,000 for federal income tax purposes which expire between 2019 and 2029. The net deferred tax asset relative to AMIC included in other assets on IHC's Condensed Consolidated Balance Sheets at June 30, 2012 and December 31, 2011 was \$7,336,000 and \$8,030,000, respectively. AMIC continues to file its own separate income tax return and is not included in the consolidated tax return of IHC.

**Note 12.**

**Reinsurance**

Effective January 26, 2012, Standard Security Life entered into a coinsurance agreement with an unaffiliated reinsurer to cede group annuity reserves. In accordance with the agreement, Standard Security Life transferred \$143,537,000 of cash in the first quarter of 2012 and recorded a corresponding amount as due from reinsurers. The Company received final approval from the New York State Insurance Department to convert the transfer from a coinsurance to an assumption agreement. When complete, the assumption will contractually relieve Standard Security Life of liability with regards to the policies.

**Note 13.**

**Supplemental Disclosures of Cash Flow Information**

Tax refunds, net of tax payments, were \$911,000 and \$3,957,000 during the six months ended June 30, 2012 and 2011.

Cash payments for interest were \$1,074,000 and \$922,000 during the six months ended June 30, 2012 and 2011, respectively.

**Note 14.****Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Information by business segment for the three months ended June 30, 2012 and 2011 is presented below (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues:</b>				
Medical Stop-Loss	\$ 34,298	\$ 30,145	\$ 69,558	\$ 60,780
Fully Insured Health	40,009	44,079	78,676	87,318
Group disability, life, annuities and DBL	12,826	15,186	25,741	30,443
Individual life, annuities and other	13,061	14,817	26,851	29,960
Corporate	20	(420)	490	130
	100,214	103,807	201,316	208,631
Net realized investment gains	1,850	1,883	2,987	1,681
Other-than-temporary impairment losses	(621)	(165)	(704)	(468)
	\$ 101,443	\$ 105,525	\$ 203,599	\$ 209,844
<b>Income from operations</b>				
<b>before income taxes:</b>				
Medical Stop-Loss	\$ 3,849	\$ 1,934	\$ 9,934	\$ 1,907
Fully Insured Health <sup>(A)</sup>	2,006	1,579	3,158	4,942
Group disability, life, annuities and DBL	733	1,772	702	1,588
Individual life, annuities and other	(172)	330	198	344
Corporate	(1,429)	(2,054)	(3,104)	(2,322)
	4,987	3,561	10,888	6,459
Net realized investment gains	1,850	1,883	2,987	1,681
Other-than-temporary impairment losses	(621)	(165)	(704)	(468)
Interest expense	(540)	(460)	(1,079)	(917)
	\$ 5,676	\$ 4,819	\$ 12,092	\$ 6,755

**(A)**

The Fully Insured Health segment includes amortization of intangible assets recorded as a result of acquisition accounting for the recent acquisitions. Total amortization expense was \$610,000 and \$604,000 for the three months ended June 30, 2012 and 2011, respectively, and was \$1,205,000 and \$1,212,000, respectively, for the six months ended June 30, 2012 and 2011. Amortization expense for the other segments is insignificant.



**ITEM 2.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL**

**CONDITION AND RESULTS OF OPERATIONS**

*The following discussion of the financial condition and results of operations of Independence Holding Company ("IHC") and its subsidiaries (collectively, the "Company") should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements of the Company and the related Notes thereto appearing in our annual report on Form 10-K for the fiscal year ended December 31, 2011, as filed with the Securities and Exchange Commission, and our unaudited Condensed Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.*

**Overview**

Independence Holding Company, a Delaware corporation ( IHC ), is a holding company principally engaged in the life and health insurance business through: (i) its insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life"), Madison National Life Insurance Company, Inc. ("Madison National Life"), and Independence American Insurance Company ( Independence American ); and (ii) its marketing and administrative companies, including IHC Risk Solutions, LLC ( Risk Solutions ), IHC Health Solutions, Inc. ( Health Solutions ), and Actuarial Management Corporation ("AMC"). These companies are sometimes collectively referred to as the Insurance Group , and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." IHC also owns a significant equity interest in a managing general underwriter ( MGU ) that writes medical stop-loss for Standard Security Life. At June 30, 2012, the Company also owned a 78.6% interest in American Independence Corp. ( AMIC ).

While management considers a wide range of factors in its strategic planning and decision-making, underwriting profit is consistently emphasized as the primary goal in all decisions as to whether or not to increase our retention in a core line, expand into new products, acquire an entity or a block of business, or otherwise change our business model. Management's assessment of trends in healthcare and morbidity, with respect to medical stop-loss, fully insured medical, disability and New York State short-term statutory disability benefit product ("DBL"); mortality rates with respect to life insurance; and changes in market conditions in general play a significant role in determining the rates charged, deductibles and attachment points quoted, and the percentage of business retained. IHC also seeks transactions that permit it to leverage its vertically integrated organizational structure by generating fee income from production and administrative operating companies as well as risk income for its carriers and profit commissions. Management has always focused on managing the costs of its operations and providing its insureds with the best cost containment tools available.



*The following is a summary of key performance information and events:*

The results of operations for the three months and six months ended June 30, 2012 and 2011 are summarized as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Revenues	\$ 101,443	\$ 105,525	\$ 203,599	\$ 209,844
Expenses	95,767	100,706	191,507	203,089
Income from operations before income taxes	5,676	4,819	12,092	6,755
Income taxes (benefits)	1,846	1,355	3,932	(509)
<b>Net income</b>	<b>3,830</b>	<b>3,464</b>	<b>8,160</b>	<b>7,264</b>
Less: Income from noncontrolling interests in subsidiaries	(299)	(424)	(707)	(1,040)
<b>Net income attributable to IHC</b>	<b>\$ 3,531</b>	<b>\$ 3,040</b>	<b>\$ 7,453</b>	<b>\$ 6,224</b>

o

Net income of \$.20 per share, diluted, for the three months ended June 30, 2012 compared to \$.17 per share, diluted, for the same period in 2011. Net income of \$.41 per share, diluted, for the six months ended June 30, 2012, compared to \$.36 per share, diluted, for the six months ended June 30, 2011.

o

Consolidated investment yields (on an annualized basis) of 3.8% and 3.9% for the three months and six months ended June 30, 2012 compared to 4.2% and 4.3% for the comparable periods in 2011;

o

Declared a special 10% stock dividend to IHC shareholders of record on February 17, 2012 with a distribution date of March 5, 2012. As a result, IHC issued 1.6 million shares of its common stock, net of treasury shares, with a fair value of \$15.8 million and paid cash in-lieu of fractional shares;

o

Announced an increase IHC's annual dividend from \$.05 to \$.07 per share; and

o

Book value of \$15.13 per common share, an increase of \$.67 per common share from \$14.46 at December 31, 2011.

***The following is a summary of key performance information by segment:***

o

The Medical Stop-Loss segment reported income before taxes of \$3.8 million for the second quarter of 2012 compared to \$1.9 million in the same quarter in 2011, and reported income before taxes of \$9.9 million for the first six months of 2012 compared to \$1.9 for the first six months of 2011. The increase is primarily due to increased volume and improved loss ratios in 2012;

o

Premiums earned increased \$6.6 million and \$11.3 million for the three months and six months ended June 30, 2012, respectively, when compared to the same periods in 2011. The increase in premiums earned is primarily due to increased volume and retention on business underwritten by Risk Solutions.

o

Underwriting experience for the Medical Stop-Loss segment, as indicated by its GAAP Combined Ratios, are as follows for the periods indicated (in thousands):



	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Premiums Earned	\$ 33,984	\$ 27,421	\$ 66,635	\$ 55,316
Insurance Benefits, Claims & Reserves Expenses	22,588	18,233	40,995	39,127
	8,951	8,351	18,475	16,602
Loss Ratio <sup>(A)</sup>	66.5%	66.5%	61.5%	70.7%
Expense Ratio <sup>(B)</sup>	26.3%	30.4%	27.7%	30.0%
Combined Ratio <sup>(C)</sup>	92.8%	96.9%	89.2%	100.7%

o

Loss ratios for the six months ended June 30, 2012 decreased due to improved underwriting results in business produced by both Risk Solutions and by independent MGUs.

o

The expense ratio decreased for the three months and six months ended June 30, 2012 primarily due to a decrease in profit commission expense as a result of poor performance on certain business written through one program at AMIC.

(A)

Loss ratio represents insurance benefits, claims and reserves divided by premiums earned.

(B)

Expense ratio represents commissions, administrative fees, premium taxes and other underwriting expenses divided by premiums earned.

(C)

The combined ratio is equal to the sum of the loss ratio, profit commission expense ratio and the expense ratio.

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The Fully Insured Health segment reported \$2.0 million of income before taxes for the three months ended June 30, 2012 as compared to \$1.6 million for the comparable period in 2011, and reported \$3.2 million of income before taxes

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for the six months ended June 30, 2012 compared to \$4.9 million for the same period in 2011.

o

Premiums earned decreased \$3.5 million and \$8.2 million for the three months and six months ended June 30, 2012 over the comparable 2011 periods primarily due to decreased volume and retentions in certain lines of the business.

o

Underwriting experience, as indicated by its GAAP Combined Ratios, for the Fully Insured segment are as follows for the periods indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Premiums Earned	\$ 32,982	\$ 36,452	\$ 65,067	\$ 73,247
Insurance Benefits, Claims & Reserves	21,370	24,888	42,382	46,432
Expenses	9,706	10,662	19,116	22,219
Loss Ratio	64.8%	68.3%	65.1%	63.4%
Expense Ratio	29.4%	29.2%	29.4%	30.3%
Combined Ratio	94.2%	97.5%	94.5%	93.7%

o

The increase in the loss ratio for the six-month period was primarily attributable to an increase in the claims experience on major medical business for groups and individuals and dental businesses in the first quarter of 2012 partially offset by a decrease in claims experience on major medical business for groups and individuals in the second quarter of 2012.

o

The underwriting expense ratio decreased for the six months ended June 30, 2012, primarily as a result of a decrease in general expenses.